

## Message Text

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ACTION EA-12

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TO SECSTATE WASHDC 9659  
INFO AMCONSUL HONG KONG  
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AMEMBASSY LONDON  
AMEMBASSY MOSCOW  
AMEMBASSY PARIS  
AMEMBASSY TAIPEI  
AMEMBASSY TOKYO  
CINCPAC HONOLULU HI

C O N F I D E N T I A L SECTION 1 OF 2 PEKING 0144

CINCPAC FOR POLAD

E.O. 11652: GDS  
TAGS: ECON ELAB EEWT CH  
SUBJ: PRC INDUSTRIAL PERFORMANCE IN 1977 AND OUTLOOK FOR 1978:  
THE VIEW FROM PEKING

REF: PEKING 2635 (NOTAL)

1. SUMMARY: ALTHOUGH PRC INDUSTRIAL RECOVERY IN 1977 WAS MORE  
VIGOROUS THAN THE LEADERSHIP EXPECTED, GROWTH SLOWED MARKEDLY  
IN THE FINAL QUARTER AS THE ECONOMY BRUSHED UP AGAINST STRUCTURAL  
BOTTLENECKS AND INEFFICIENCIES. THE OUTLOOK FOR 1978 IS FOR  
CONTINUED SLOW GROWTH IN THE FACE OF THESE PROBLEMS, WHICH WILL  
CONTINUE TO INHIBIT RAPID GROWTH DURING THIS DECADE. LOOKING  
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BEYOND THE PUFFERY OF PLAN FULFILLMENT CLAIMS, WE PERCEIVE THAT  
LAST YEAR'S PERFORMANCE HIGHLIGHTED SEVERE STRUCTURAL WEAKNESSES IN  
SUCH BASIC INDUSTRIES AS STEEL, COAL, ELECTRIC POWER AND  
TRANSPORTATION. BRIGHTER SPOTS IN THE ECONOMY ARE OIL AND GAS  
PRODUCTION AND PERFORMANCES OF SUCH "SUPPORT AGRICULTURE"  
INDUSTRIES AS CHEMICAL FERTILIZER AND AGRICULTURE" INDUSTRIES AS  
CHEMICAL FERTILIZER AND AGRICULTURAL MACHINERY. LIGHT INDUSTRIAL

OUTPUT HAS REBOUNDED BUT REMAINS FAR BEHIND EVER INCREASING CONSUMER DEMAND.

2. THE CHINESE LEADERSHIP HAS SINGLED OUT ELECTRIC POWER, STEEL, FUELS AND TRANSPORTATION AS AREAS REQUIRING SUBSTANTIAL NEW INVESTMENTS, INCLUDING IMPORTATION OF FOREIGN TECHNOLOGY, TO ACHIEVE LARGE CAPACITY ADDITIONS NEEDED IN THE MEDIUM-LONG TERM. MEANWHILE, CHINA CONTINUES TO BUILD-UP FOREIGN AND DOMESTIC PLANTS IN THE PETROCHEMICALS AND "SERVE AGRICULTURE" FIELDS AND TO RELY PRIMARILY ON LOCAL CAPITAL ACCUMULATION TO HASTEN AGRICULTURAL OUTPUT. IN EFFECT, 1978 WILL BE ANOTHER "YEAR OF PREPARATION" FOR ANOTHER HOPED-FOR LEAP IN PRODUCTION IN THE SIXTH FIVE YEAR PLAN PERIOD (1981-1985). END SUMMARY.

3. INDUSTRIAL PERFORMANCE IN 1977: COMMENTS AND IMPRESSIONS. PEKING ANNOUNCED IN ITS NEW YEAR'S EDITORIAL THAT LAST YEAR'S 14 PERCENT INCREASE IN GROSS INDUSTRIAL OUTPUT VALUE OVER 1976 WAS 6 PERCENT-AGE POINTS OVER THE PLANNERS' ESTIMATE EARLIER IN THE YEAR. THIS BETTER-THAN-EXPECTED PERFORMANCE SEEMS TO HAVE BEEN ACHIEVED IN THE SECOND AND THIRD QUARTERS. OUR CALCULATIONS BASED ON PARTIAL BVIO CLAIMS DURING THE YEAR INDICATE THAT THERE WAS LITTLE INCREASE IN GVIO IN THE FOURTH QUARTER. WE ESTIMATE 1977 GVIO AT TEN OR TWELVE PERCENT OVER 1975. THUS, AVERAGE ANNUAL GROWTH IN THE 1976-1977 PERIOD WAS ABOUT 5-6 PERCENT.

4. THE PIVOTAL RAILWAY TRANSPORT SECTOR SEEMS TO HAVE LED THE CONFIDENTIAL

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EARLY RECOVERY BY ACHIEVING STEADY MONTH-TO-MONTH INCREASE IN FREIGHT HAULAGE DURING THE SECOND QUARTER. WE HEARD FEWER SUPERLATIVES ABOUT RAILWAY TRANSPORT AS THE YEAR PROGRESSED AND, ALTHOUGH PREFULFILLMENT OF TRANSPORT TARGETS WAS ANNOUNCED FOR THE YEAR, NOTHING SUGGESTS THAT THE STRONG SECOND QUARTER TRENDS WERE SUSTAINED OR THAT OVERALL PERFORMANCE IMPROVED SIGNIFICANTLY OVER PAST YEARS (I.E., NO PERCENTAGE INCREASE CLAIMS OVER 1975 OR 1976 WERE MADE). THE STATE INCREASED BUDGETARY ALLOCATIONS FOR CONSTRUCTION OF NEW LINES AND PRODUCTION OF LOCOMOTIVES AND ROLLING STOCK (NCNA JANUARY 8) AND THE TIENTSIN-SHANGHAI DOUBLE TRACK WAS COMPLETELY OPENED TO TRAFFIC. NEVERTHELESS, THERE IS NO EVIDENCE THAT THE GENERAL LEVEL OF MECHANIZATION IN LOADING AND UNLOADING WAS RAISED SIGNIFICANTLY OR THAT TRAFFIC CONTROL SYSTEMS WERE UP-GRADED.

5. THE COAL INDUSTRY REBOUNDED TO SOME EXTENT IN 1977, PROVIDING CRITICAL SUPPORT FOR THE RECOVERY. THIS SECTOR ENDED THE YEAR WITH NATIONAL PRODUCTION MORE THAN 10 PERCENT ABOVE LAST YEAR, THE BEST PERFORMANCE IN RECENT YEARS (ALTHOUGH THE 10 PERCENT FIGURE IS MISLEADING BECAUSE THE COMPARISON IS BEING MADE WITH A DEPRESSED YEAR). NCNA ANNOUNCED THAT CHINA'S MAJOR MINES INCREASED OUTPUT BY 8 PERCENT OVER LAST YEAR. MUCH OF THIS INCREASE CAN PROBABLY BE

ATTRIBUTED TO RESTORATION OF NORMAL PRODUCTION AT A NUMBER OF MAJOR MINES -- INCLUDING PINGTINGSHAN, CHIAOTSO, HOPI AND HOKANG -- AND THE THIRD QUARTER RECOVERY OF KAILUAN (PEOPLE'S DAILY, DECEMBER 21). CAPACITY ADDITIONS OF ABOUT 10 MILLION TONS (NCNA DECEMBER 31) WERE MODEST AND IT IS UNLIKELY THAT MECHANIZATION LEVELS WERE RAISED ENOUGH TO ENSURE LONGER-TERM HIGH GROWTH. IN 1977 THIS INDUSTRY CONTINUED TO "TAP POTENTIAL" AT EXISTING LARGE MINES AND DEVELOP SMALL MINES RATHER THAN DEVELOP NEW LARGE MINES WHICH MIGHT RAISE OUTPUT SUBSTANTIALLY IN THE MEDIUM-LONG TERM.

6. ALTHOUGH THE RATE OF GROWTH OF PETROLEUM OUTPUT DECLINED STEADILY THROUGHOUT THE YEAR, DOWN TO 8 PERCENT  
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AT THE END OF 11 MONTHS COMPARED WITH THE SAME 1976 PERIOD, IT IS TOO EARLY TO CONCLUDE THAT PRODUCTION IS FALLING BELOW REQUIREMENTS OR WILL DO SO IN THE NEAR FUTURE. THE MODEST GVIO INCREASE RATE IN 1976-1977 PROBABLY MEANS THAT PETROLEUM REQUIREMENTS HAVE GROWN SLOWLY. CONSIDERING ALSO THAT EXPORT DEMAND HAS GROWN ONLY marginally SINCE 1976, WE WOULD CONCLUDE THAT 1977 PRODUCTION WAS IN LINE WITH OR PERHAPS EXCEEDED REQUIREMENTS (SEE 1977 PEKING 3033). IT WOULD ALSO APPEAR THAT THE PRC CARRIED OUT EXTENSIVE EXPLORATORY AND PRODUCTION DRILLING PROGRAMS AND PURCHASED LARGE AMOUNTS OF OILFIELD EQUIPMENT IN 1977, THE FRUITS OF WHICH ACTIONS WILL BE SEEN IN THE YEARS AHEAD.

7. UPBEAT MEDIA RELEASES HAVE OBFUSCATED THE CONTINUING, CRITICAL INADQUACY OF THE PRC IRON AND STEEL INDUSTRY. LAST YEAR'S INCREASE OF SOME 13 PERCENT MAY HAVE BROUGHT CRUDE STEEL PRODUCTION TO 22-23 MILLION TONS WHICH IS FAR BELOW REQUIREMENTS AND WELL BELOW THE PEAK YEAR OF 1973 (SEE PEKING 12). MODERN PLANTS BOOSTED PRODUCTION MARKEDLY IN THE THIRD AND FOURTH QUARTERS, BUT HIGH OUTPUT LEVELS WERE PROBABLY ACHIEVED AT UNSUSTAINABLY HIGH CAPACITY UTILIZATION RATES AND FACILITATED BY THE SHORT-TERM ABUNDANCE OF STOCKPILED RAW MATERIALS. SMALL AND MEDIUM IRON AND

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R 170033Z JAN 78  
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C O N F I D E N T I A L SECTION 2 OF 2 PEKING 0144

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STEEL PLANTS SEEM TO HAVE MERELY MATCHED PREVIOUS  
OUTPUT LEVELS, (SEE KWANGMING DAILY, DECEMBER 27),  
PROBABLY INDICIATING THAT NO EFFORT IS BEING MADE TO  
EXPAND OUTPUT OF THEIR LOW-QUALITY PRODUCTS. ON THE  
BRIGHTER SIDE, NCNA CLAIMED AT YEAR-END RESTORATION  
OF PRE-EARTHQUAKE PRODUCTION AT THE IMPORTANT (800,000  
TONS PER YEAR) TANGSHAN STEEL PLANT.

8. CHINA MADE SOME PROGRESS IN INCREASING ELECTRIC  
POWER GENERATION IN 1977, ACHIEVING A GROWTH OF 9.8  
PERCENT IN THE FIRST ELEVEN MONTHS COMPARED WITH THE  
SAME 1976 PERIOD, AND ADDING OVER 40 LARGE AND MEDIUM  
SIZED HYDRO AND THERMO GENERATING UNITS (NCNA JANUARY 1).  
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INCREASES IN PWER GENERATION IN 1977 DID NOT KEEP  
PACE WITH THE INCREASE IN GVIO, HOWEVER, A SHORTFALL  
WHICH PROBABLY EXACERBATED SHORTAGES IN INDUSTRIAL  
AREAS WHICH HAVE NECESSITATED POWER RATIONING AND  
CURTAILMENT OF PRODUCTION AT SOME PLANTS. LAST YEAR  
THE STATE INCREASED BUDGETARY ALLOCATIONS FOR POWER  
PLANT CONSTRUCTION PROJEGCTS IN THE INDUSTRIAL NORTH  
AND NORTHEAST AND ELSEWHERE. NO SHORT-TERM SOLUTION

IS IN SIGHT, HOWEVER, AND ELECTRIC POWER SEEMS TO HAVE DEVELOPED INTO A KEY BOTTLENECK.

9. "SUPPORT AGRICULTURE" INDUSTRIES, SUCH AS CHEMICAL FERTILIZER AND AGRICULTURAL EQUIPMENT, ACHIEVED LARGE PERCENTAGE GAINS OVER 1976 EITHER AS A RESULT OF LARGE ADDITIONS TO CAPACITY (FOR CHEMICAL FERTILIZER) (SEE HONG KONG 15424, 1977) OR EXPANSION PLUS MORE EFFECTIVE USE OF EXISTING CAPACITY (FOR TRACTOR PRODUCTION). INDUSTRIES SUPPORTING AGRICULTURE HAVE ENJOYED A HIGH PRIORITY FOR YEARS, AND SOME PROGRESS IS NOW BEING SEEN. FIVE FAIRLY LARGE FARM MACHINERY PLANTS WERE COMPLETED IN 1977, INCLUDING A LARGE TRACTOR PLANT IN HOPEI PROVINCE (NCNA JANUARY 1).

10. THE PERFORMANCE OF LIGHT INDUSTRY WAS STRONG THROUGHOUT 1977. A NATIONAL LIGHT INDUSTRIAL CONFERENCE WAS HELD EARLY IN THE YEAR, INDICATING THIS SECTOR'S IMPORTANCE AS A SUPPLIER OF CONSUMER GOODS AND PROFIT FOR THE STATE. CONSUMER GOODS' SUPPLY REMAINS FAR BEHIND INCREASING DEMAND, HOWEVER, AND STRICT AND INCENTIVE-LIMITING RATIONING FOR MANY BASIC PRODUCTS REMAINS IN EFFECT.

11. OUTLOOK FOR 1978 AND BEYOND: PRIORITIES AND PLANS. NINETEEN SEVENTY-SEVEN WAS A YEAR OF PARTIAL

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RECOVERY, PREPARATION AND, IMPORTANTLY, PLANNING. THE STATE PLANNING COMMISSION DREW UP THREE-YEAR AND EIGHT-YEAR PLANS BEGINNING IN 1978 (NCNA DECEMBER 31). WE SEE 1978 AS ANOTHER YEAR OF PREPARATION AND CATCHING UP. WE EXPECT SOME IMPORTANT PROGRESS THIS YEAR IN COMPLETING AND BRINGING ON-STREAM OF SUCH ON-GOING PROJECTS AS THE POWER GENERATING PLANTS IN TIENTSIN AND TANGSHAN, CRUDE STEEL AND STEEL FINISHING PLANTS IN WUHAN, FRENCH FERTILIZER PLANTS IN ANHUI (ANHWEI), NANKING AND KWANGCHOW, KELLOGG FERTILIZER PLANTS IN HUNAN AND HUPEI AND KWEICHOW, AND FRENCH PETROCHEMICALS PLANTS IN LIAOYANG (LIAONING). GREATER EFFORTS ARE LIKELY TO BOOST PRODUCTION OF AGRICULTURAL MACHINERY AND TO IMPROVE CHEMICAL FERTILIZER DISTRIBUTION.

12. BEGINNING THIS YEAR AND CONTINUING THROUGH THE END OF THIS DECADE, WE EXPECT SOME STEPS TO BE TAKEN TOWARD ALLEVIATING SEVERE STRUCTURAL BOTTLENECKS IN THE ECONOMY AND PREPARING THE WAY FOR A MORE COMPREHENSIVE INDUSTRIAL EXPANSION DURING THE SIXTH FIVE YEAR PLAN PERIOD (1981-1985). STEPS MIGHT INCLUDE AGREEMENTS WITH FOREIGN FIRMS, PRIMARILY JAPANESE, TO MODERNIZE AND EXPAND PRODUCTION AT CAPITAL AND AISHAN IRON AND STEEL COMPANIES AND THE EMINENTLY

PRACTICAL STEP OF CONSTRUCTING A NEW STEEL PLANT LOCATED ON THE COAST WHICH CAN MAKE USE OF IMPORTED IRON ORE AND POSSIBLY COKING COAL. OTHER PLANTS MAY BEGIN MAKING MORE USE OF IMPORTED PGI IRON, A STEP WHICH WILL REDUCE THE COAL AND IRON ORE TRANSPORT BURDEN OF THE RAILWAYS.

13. OTHER IMPORTANT STEPS MAY BE AGREEMENTS WITH FOREIGN FIRMS TO MODERNIZE AND EXPAND TRUCK PRODUCTION, PROBABLY BY BUILDING A NEW PLANT INCORPORATING FOREIGN TECHNOLOGY; STEPPED UP CONSTRUCTION OF COAL-FIRED POWER PLANTS AND HYDROELECTRIC PLANTS; ADDITIONAL AGREEMENTS WITH FOREIGN SUPPLIERS FOR PERHAPS A DOZEN MORE CHEMICAL

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FERTILIZER PLANTS; AND ADDITIONS TO PETROLEUM REFINING CAPACITY. STEPS THAT MIGHT BE TAKEN TO IMPROVE RAILWAY TRANSPORT CAPACITY INCLUDE INCREASING THE MECHANIZATION FOR LOADING AND UNLOADING, FURTHER DIESELIZATION AND IMPROVEMENT OF MARSHALLING YARD AND SIGNALLING TECHNOLOGY. HOWEVER, INCREASING EFFICIENCY IN THIS SECTOR IS LIKELY TO BE PARTICULARLY SLOW AND ARDUOUS.

14. THESE STEPS WILL BE TAKEN ALONGSIDE ON-GOING EFFORTS TO DISCOVER AND EXPLOIT NEW OILFIELDS, RAISE MECHANIZATION LEVELS IN EXTRACTIVE INDUSTRIES AND, TO THE EXTENT ALLOWED BY RESOURCE CONSTRAINTS, INCREASE CONSUMER GOODS SUPPLIES. WE EXPECT CONTINUED EFFORTS TO IMPROVE LABOR PRODUCTIVITY AND MANAGEMENT EFFICIENCY THROUGHOUT THE INDUSTRIAL SECTOR. FAINALLY, A CRASH PROGRAM WILL BE INSTITUTED TO TRAIN TECHNICIANS AT ALL LEVELS OF INDUSTRY IN ORDER TO INCREASE THE PRC'S PRESENTLY LIMITED TECHNICAL ABSORPTIVE CAPACITY.

15. AS VIEWED FROM PEKING, THE PROGNOSIS FOR 1978-1979 IS FOR MODERATE INDUSTRIAL GROWTH IN THE FACE OF DIFFICULT STRUCTURAL PROBLEMS WHICH CANNOT BE ALLEVIATED IN THE SHORT-TERM. HOWEVER, EVEN MODERATE GROWTH WILL BE DIFFICULT OR IMPOSSIBLE TO ACHIEVE IF (A) THE PRC IS ONCE AGAIN WRACKED BY POLITICAL FACTIONALISM, OR (B) GRAIN HARVESTS FAIL TO INCREASE. FURTHERMORE, GROWTH PROSPECTS DEPEND ON IMPROVED ECONOMIC PLANNING AND CHINESE ACCEPTANCE OF EXPANDED AND LONGER-TERM TRADE CREDITS FROM FOREIGN SUPPLIERS. AT PRESENT, WE WOULD VENTURE THAT THE PITFALLS CAN BE AVOIDED IN THE NEXT TWO YEARS AND THAT THE ECONOMIC IMPERATIVES WILL CONTINUE TO NECESSITATE PRAGMATIC SOLUTIONS TO CHINA'S PRESENT PROBLEMS OF DEVELOPMENT. AS INDICATED IN OUR PREVIOUS REVIEW

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OF THE PRC ECONOMY (EEFTEL), WE REMAIN CAUTIOUSLY OPTIMISTIC  
ON THE PROSPECTS FOR CONTINUED GRADUAL IMPROVEMENT IN VOLVING  
STRUCTURAL PROBLEMS FACING THE ECONOMY.

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## Message Attributes

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